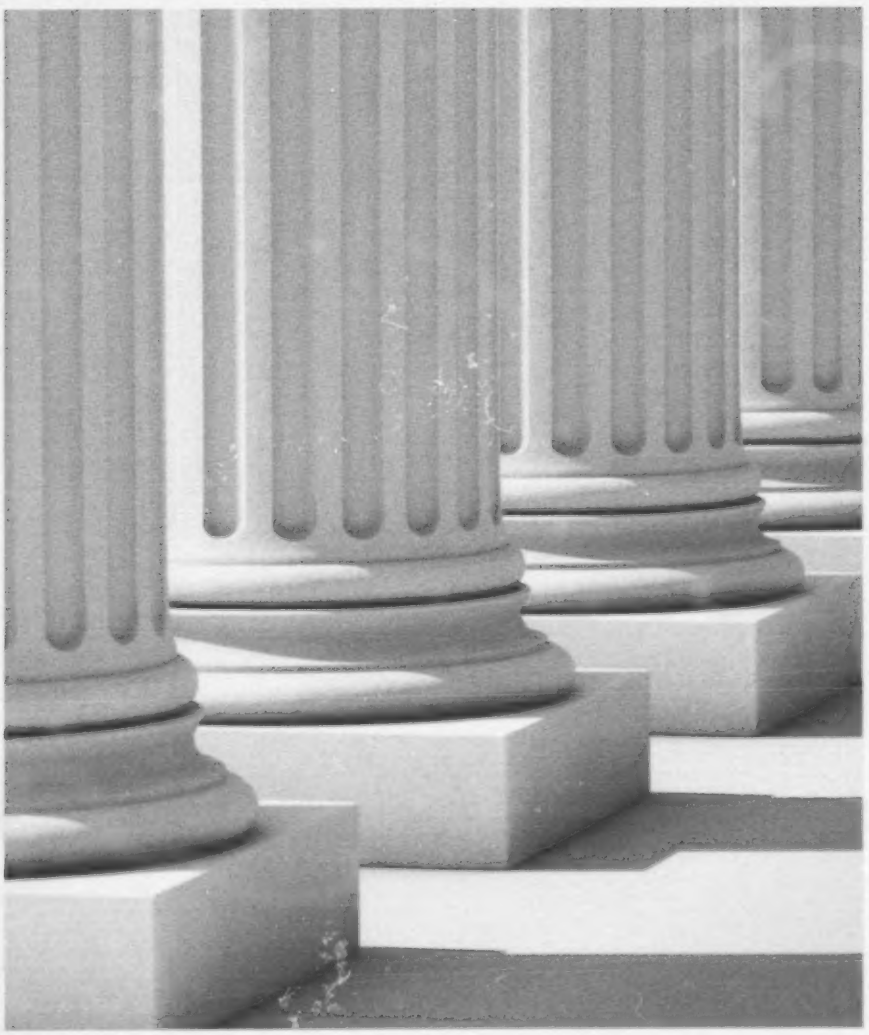
ALBERTA
LAW REFORM
INSTITUTE

NON-PROFIT CORPORATIONS



DISCUSSION PAPER
FOR NON-PROFIT
ORGANIZATIONS
FEBRUARY 2015

Discussion Paper for Non-Profit Organizations

February 2015

[1] The non-profit sector is an integral part of our economy, society and way of life. It is a growing component in the province-wide delivery of an array of services, such as education, training, housing, food banks, healthcare, and recreation.

[2] As in other sectors, non-profit organizations must demonstrate and maintain levels of relevancy, adaptability, competency and efficiency in an increasingly challenging environment. One way to help non-profits keep pace with these demands is to provide an incorporation mechanism that will allow them to meet challenges as they arise.

[3] More than ever, Alberta's non-profit sector needs clear and user-friendly legislation that:

- puts in place tools to help non-profit organizations accomplish their specific objectives,
- is flexible enough to accommodate the diversity of the non-profit sector and the changing circumstances of the organizations when needed,
- plainly articulates the roles, responsibilities and rights of both directors and members, and
- eliminates requirements that do not meaningfully advance the interests of stakeholders.

[4] Non-profit organizations and regulators are often working within limited means. The balance between requirements and the ability to comply is crucial, so that human and financial resources can be dedicated to the objectives of the organization and to the appropriate role of the regulator. The first step in achieving such balance is not only to get input from non-profits themselves, but also from those who interact with these organizations, including corporate authorities, granting agencies and legal advisers.

[5] To this end, the Alberta Law Reform Institute (ALRI) has worked in collaboration with representatives of various types of stakeholders to develop a better understanding of the issues each respectively deal with. As part of this consultation process, ALRI now releases a Report for Discussion, available online at:

<www.alri.ualberta.ca/docs/rfd026.pdf>. The Report contains a series of preliminary recommendations designed to provoke feedback in the following key areas.

Approach and Principles

[6] A group of people with a common purpose may wish to formalize their operations into a legal structure. One option is to incorporate. In Alberta, organizations that operate for a purpose other than the monetary gain of their members may incorporate as a society under the *Societies Act* or a non-profit company under Part 9 of the *Companies Act*. While these two statutes provide mechanisms for incorporation, they lack guidance in a number of respects, especially the function of the stated purpose, the obligations of those running the organizations, the rights of those responsible for holding them to account, and how internal disputes should be dealt with.

For further information see Report for Discussion, Pages 10–11 and Recommendation 1.

[7] ALRI recommends replacing the current *Societies Act* and *Companies Act* with a single act, which we believe will better serve organizations, their members and the general public as well. The new act should set out modern requirements for the governance structures of non-profit corporations. These requirements should apply to all corporations unless they adopt their own. Otherwise, we think that corporations should have the flexibility to adjust the operating environment to suit their specific needs and circumstances. Therefore, any matters that are not specifically regulated in the act should be left up to the corporations, including the choice to restrict their purposes, activities or powers in order to meet requirements of fundraising or tax legislation.

For further information see Report for Discussion, Pages 12–14, and Recommendations 3 and 4.

Incorporation and Capacity

[8] An application for a certificate of incorporation should only require the submission of the articles of incorporation, the notice of directors, the notice of registered office, and the NUANS name search report. At a minimum, the articles should include the name of the corporation, a statement of purpose, a class of membership with voting rights, the minimum and maximum number of directors, an election respecting the distribution on dissolution, and any restrictions on the powers or activities of the corporation.

For further information see Report for Discussion, Pages 18–19 and Recommendation 7.

[9] Corporations should not have to submit by-laws with their application to obtain a certificate of incorporation. However, the act should require that they be filed within the prescribed period of time after the members have confirmed them. As with articles, by-laws or amendments to by-laws should no longer be subject to the review and approval of the corporate authorities.

For further information see Report for Discussion, Page 21 and Recommendation 9.

[10] The function of the corporate authorities/regulators should be to make sure that the articles and by-laws include all required items, rather than to review and approve the content of those documents. Once incorporated, non-profit corporations will have all the powers of a natural person, unless otherwise provided in their governing documents. Corporations that wish to apply for tax-exempt status under the *Income Tax Act* will have the responsibility to make sure that their governing documents include appropriate purposes and restrictions.

For further information see Report for Discussion, Pages 24–26 and Recommendation 11.

[11] Funding is one of the biggest challenges facing organizations, which are often competing for a limited pool of money. Current legislation significantly restricts the ability of non-profit corporations to engage in activities that generate revenue surpluses or accretions, even when those activities are in support of their stated purposes. ALRI recommends that corporations be free to carry on "business" activities that are incidental or ancillary to their purposes as long as members do not personally profit financially from those activities.

For further information see Report for Discussion, Pages 30–33 and Recommendation 14.

[12] Corporations should not be allowed to distribute assets directly to members during their existence as this is the key feature that sets non-profit corporations apart from for-profit corporations. However, to better accommodate member benefit corporations, especially existing Part 9 non-profit companies, ALRI recommends the establishment of a two-part model: (1) fully restricted corporations, and (2) partly restricted corporations. This two-part model will preserve the prohibition against asset distribution during existence for all corporations while giving organizations such as golf clubs the option to incorporate as partly restricted corporations, thereby having the ability to divide up remaining property on dissolution, with tax consequences.

For further information see Report for Discussion, Pages 33–38 and Recommendation 15.

Directors' and Officers' Duties and Liabilities

[13] Non-profit corporations are expected to adopt sound governance standards for how they manage, operate and govern their organizations. ALRI does not propose to create new obligations for directors and officers. Rather, the objective is to draw attention to what is expected from those running non-profit corporations by including a list of the directors' and officers' duties and liabilities in the new act. Although case law provides some help, we think that additional guidance would be of great benefit in a sector where those who serve on boards are in most cases unpaid volunteers with variable degrees of expertise and experience. The act should also include specific rules for dealing with conflicts of interest, including material interest and dual loyalty issues.

For further information see Report for Discussion, Pages 45–48 and Recommendations 18 and 19.

[14] While directors' and officers' personal liability remains an exception, ALRI recommends the introduction of mechanisms to further mitigate the risks of being held personally responsible for the actions or omissions of the corporation they serve, including a dissent procedure, a due diligence defence, and court relief from personal liability. Corporations should also be able to indemnify their directors and officers or purchase insurance to cover that indemnity, because exposing those individuals to personal liability when they are acting in good faith and within the authority granted by the incorporating statute and governing documents may make it more difficult to attract candidates into these roles.

For further information see Report for Discussion, Pages 57–61 and Recommendations 24 and 25.

Members' Roles and Rights

[15] Members have primary responsibility for holding non-profit corporations to account. With that should come a number of entitlements which enable them to fulfill that responsibility, including the right to access corporate information, to attend meetings of the members, to elect and remove directors, to approve key amendments to governing documents and fundamental changes, to ensure that corporate powers are used in furtherance of the stated purposes, and to submit proposals to other members on any matters they wish to discuss at a meeting. Because of the importance of these rights, the act should require corporations to set out the process for admitting and terminating members. Corporations should also be obligated to maintain an up-to-date list of members.

For further information see Report for Discussion, Pages 64–66 and Recommendation 26; Pages 72–73 and Recommendation 32; and Pages 79–80 and Recommendation 39.

[16] Corporations should be encouraged to limit membership to those who take positive steps to indicate their intention to participate in the governance of their organizations. Although non-profit corporations should remain free to create classes of members that do not carry voting rights as a way to affiliate participants, patrons, volunteers or donors, ALRI recommends that the members of those classes have no entitlement under the new act. Corporations that wish to confer rights on non-voting members with respect to specific matters affecting their classes of members should so provide in their articles or by-laws.

For further information see Report for Discussion, Pages 67–68 and Recommendation 28.

Financial Accountability and Transparency

[17] An accountable non-profit sector is important. However, we think that the responsibility to hold corporations accountable for the stewardship of monies received and the safety or quality of services provided should rest with the members. Corporations should be required to place annual financial statements before the members at the annual general meeting, and subsequently allow the members meaningful access to books and records upon request.

For further information see Report for Discussion, Pages 81–83 and Recommendation 40.

[18] To reduce compliance costs, ALRI also recommends removing provisions requiring corporations to file audited financial statements with the corporate authorities as part of their annual report. Because financial statements would no longer be accessible through a corporate registry search, third parties requiring copies of these statements will have to request them directly from the corporations (e.g. an organization receiving a grant may have to provide financial statements to the grantor as a condition of receiving the grant).

For further information see Report for Discussion, Pages 84–86 and Recommendation 42.

[19] Similarly, we believe that corporations are generally in the best position to determine the appropriate level of formality for the review of their financial statements, that is, internal audit, review engagement or external audit. ALRI recommends leaving corporations free to set out financial review requirements in their by-laws in accordance with the wishes of their members, grantors or other stakeholders. The act should,

however, include a default provision requiring the conduct of a review engagement where the by-laws are silent.

For further information see Report for Discussion, Pages 88–91 and Recommendation 45.

Fundamental Changes

[20] During their existence, corporations may go through a number of fundamental changes, including amalgamation and merger of corporations, continuance into other jurisdictions, or sale of or disposition of substantially all corporate assets. These changes can significantly affect the rights of members and other stakeholders. ALRI recommends the inclusion of procedures designed both to facilitate these fundamental changes and to ensure the protection of those involved.

For further information see Report for Discussion, Pages 94–97 and Recommendations 47, 48, and 49.

[21] Additionally, corporations may sometimes have to wind up their operations. The new act should include provisions with respect to the voluntary liquidation and dissolution, administrative dissolution and judicial dissolution of non-profit corporations. ALRI recommends that corporations that elect to incorporate as fully restricted corporations under the act be required to distribute their net assets to other fully restricted corporations, registered charities or qualified donees within the meaning of the *Income Tax Act*. Corporations that choose to incorporate as partly restricted corporations should retain the ability to distribute any remaining property to their members on dissolution.

For further information see Report for Discussion, Pages 97–99 and Recommendation 50.

Registration of Extra-provincial Corporations

[22] Corporations that are incorporated in another jurisdiction but carry on business in Alberta must be registered in the province. Although the registration requirement applies to all for-profit and non-profit corporations, the data indicates that only a small number of extra-provincial non-profit corporations are currently registered. The reason may be that corporations incorporated under non-profit legislation in another jurisdiction may not be aware that they must register in Alberta as this requirement is found only in our *Business Corporations Act*. To bring some clarity, ALRI recommends that the registration requirement for extra-provincial corporations be included in the non-profit legislation too.

For further information see Report for Discussion, Pages 101–102 and Recommendation 51.

Corporate Remedies

[23] Disputes within organizations can be very time consuming and costly. In some cases, consequences are so serious that organizations are no longer able to fulfill the purposes for which they were created. There is a strong need to provide better procedures for members to hold corporations to account and more guidance about how to deal with internal disputes. The new act should give preference to internal remedies over external remedies and collective remedies over individual remedies.

For further information see Report for Discussion, Page 103 and Recommendation 52.

[24] Corporations should be encouraged to establish their own procedures for settling disputes, dissension or controversies among their directors, officers, members or volunteers. ALRI also recommends the inclusion of internal remedies aimed at eliminating the need for court intervention, including a right for members to requisition a meeting to resolve matters arising out of the operations of the corporation, or to be paid back the value of their membership when some important changes from which they dissent are undertaken.

[25] Where these internal remedies fail to resolve disputes, ALRI recommends there should be procedures by which directors, officers or members may apply to enforce rights arising under the act, regulations, articles or by-laws, including an application for a compliance or restraining order, or for leave to bring a derivative action in the name or on behalf of the corporation. However, we think that remedies designed to give courts the jurisdiction to redress direct financial losses suffered by individual stakeholders, such as an oppression remedy or application for court-ordered liquidation and dissolution, have no real relevance outside the for-profit context.

For further information see Report for Discussion, Pages 104–111 and Recommendations 54, 55, and 56.

Transitional Issues

[26] Existing corporations will need to take positive steps to continue under the new act and check that their governing documents comply with any new requirements. Because of the flexibility of the proposed regime, we believe that many corporations will have little to do to be in compliance. Nonetheless, we recognize that the transition process can be lengthy and require an adequate transition period. ALRI recommends

that period to be no less than three years. The corporate authorities should have the power to dissolve a corporation that has failed to make the transition into the new act within the transition period, but dissolution should not be automatic.

For further information see Report for Discussion, Pages 119–120 and Recommendation 61.

[27] To facilitate the transition process, ALRI recommends that there be model by-laws available for corporations that do not have ready access to legal advisers. Model by-laws will provide a simple, cost-effective way to incorporate or continue under the new act. However, corporations should be encouraged to put time and effort into drafting by-laws that better reflect their own needs and circumstances. The Report for Discussion identifies a number of areas that should be given serious thought.

For further information see Report for Discussion, Page 121 and Recommendation 62.

We invite your comments on the questions raised in this paper. Please go to the online survey on our website at **http://bit.ly/alrinonprofit**.